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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

IN THE MATTER OF PROPOSED REORGANIZATION OF THE WESTERN TOOL & MANUFACTURING COMPANY, A CORPORATION,
Debtor.

OWEN N. PRICE, Trustee for Bondholders of The Western Tool & Manufacturing Co., and Roy Massena, E. J. Price, W. D. Hollister and W. T. Kettering, Bondholders' Protective Committee for Holders of Bonds of The Western Tool & Manufacturing Co.,
Petitioners,

vs.

JAMES G. GURNEY, Individually and on Behalf of Other Shareholders of The Western Tool & Manufacturing Co.,
Respondent.

Brief for Respondent.

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JAMES G. GURNEY, Individually and on Behalf of Other Shareholders of The Western Tool & Manufacturing Co.,
Respondent.

Brief for Respondent.

STATEMENT OF THE CASE.

This brief is intended to supplement respondent's Answer In Opposition To Petition For Writ Of Certiorari merely to designate the allegations appearing in the

Petition For Writ Of Certiorari and Brief In Support Thereof and petitioners' Reply Brief, which are unsupported by the evidence or contradicted thereby, to answer certain arguments advanced by petitioners in those Briefs and to cite certain additional authorities.

In petitioners' Statement of Matter Involved it is alleged that the affidavit of James G. Gurney, attached to the petition (R. 4, 9), does not disclose that he acted for the other stockholders for whom he is the agent and attorney-in-fact. Not only does the affidavit state that Gurney has full power and authority to do all things which the other stockholders might or could do in the protection or advancement of their interest as shareholders of said corporation (R. 4, 5), but the attorney for petitioners stipulated (R. 29) that Mr. Gurney represented such other stockholders in the proceeding.

The following allegations in petitioners' Statement of The Case are wholly unsupported by the evidence:

1. That the reason for the institution of the foreclosure suit was that the time had arrived to dispose of the plant and business since none of the interested parties was actively engaged in its operation. Actually the foreclosure suit was instituted as the result of Mr. Gurney's demand in May 1942 (R. 8) that the Voting Trustees return, to the depositors, the stock deposited by them and that the Company take advantage of the increased demand for its products by improving its machinery and equipment and production methods (R. 29, 30).

The argumentative statement of petitioners to support this allegation is a curious one, in view of the admission which precedes it, that at the time the foreclosure suit was instituted the company's business had improved and it was operating at a profit.

2. That Gurney advocated a plan providing for his control of the company. Actually the evidence is that Gurney requested the Committee in May 1942 to utilize some of the cash the company had in its treasury, or to borrow from defense agencies set up for that purpose, to purchase new equipment which would increase the output of the company and lower its cost of production (R. 30). Gurney had previously consulted an outstanding production engineer who had agreed to make recommendations, and Gurney had offered to pay, himself, the fee of this engineer if the directors would accept the engineer's recommendations (R. 30). This request was refused despite the fact that the equipment and machinery of the company were then admittedly antiquated and inefficient (R. 65, 72).

In the same meeting, Gurney informed the Committee that, by reason of his long experience as a tool manufacturer's representative, he could sell, to his regular customers, whatever part of the increase in production was not taken by the government or its agencies, for which services he asked only the same commission which Mr. Kettering had been receiving on the few sales made by him, namely, 10% (R. 28, 30). There is not a scintilla of evidence in the record that he sought control of the company.

3. It is alleged that the failure of the quorum at the stockholders' meetings, at which the directors were elected in 1941 and 1942, was due to Gurney's absence from those meetings. The theory behind this, seemingly, is that if Gurney had been present he would have represented his mother, Stella Gurney, who had received no notice of the meeting. There is no evidence whatsoever in the record that Mr. Gurney "represented" his mother at any stockholders meeting nor of any proxy ever given for that

purpose. Being a stockholder himself, his presence at the meeting could not be deemed to be representative of any one other than himself, without such proxy. In any event, the failure to give notice of the 1942 meeting to Harlan T. Hyde could not have been waived by any act of Mr. Gurney. The record itself discloses that, as early as 1935, the election of directors was illegal for lack of quorum at the shareholders' meeting, at which such election was purportedly had (R. 49).

ARGUMENT.

I.

THE FAILURE OF THE DIRECTORS TO INSTITUTE PROCEEDINGS UNDER CHAPTER X, IN ITSELF WARRANTS THAT ACTION BY THE SHAREHOLDERS.

It is not a prerequisite to the *institution of a derivative* action by shareholders that directors be guilty of fraud. It is enough if the subject of the stockholders' complaint is an imputed violation of the rights growing out of the corporate franchise for which there is not an adequate remedy at law. *Dodge* v. *Woolsey,* 18 How. 331. It is likewise sufficient if the directors stand in a dual relation which prevents an unprejudiced exercise of their judgment. *United Cooper Co.* v. *Amalgamated Copper Co.,* 244 U. S. 261, 264. *Delaware & Hudson Co.* v. *Albany & Susquehanna R. R. Co.,* 213 U. S. 435, 447, 449.

The attitude of the directors need not be sinister to warrant such suit by the stockholders and may be sincere, but it is enough if the attitude is antagonistic to the company's interests. *Delaware & Hudson Co.* v. *Albany & Susquehanna R. R. Co.,* 213 U. S. 435, 451; *Chicago* v. *Mills,* 204 U. S. 321.

Even if it could be argued, here, that the directors of the company were not guilty of breaches of their duty to the shareholders, there cannot be the slightest doubt but that they occupied a dual position and that their failure to defend the foreclosure suit and their determined resistance to reorganization under Chapter X, are antagonistic to the interests of the company. Even if the foreclosure suit had been instituted by an independent mort-

gagee, it would have been antagonistic to the company's interest for the directors to refuse to seek a reorganization under Chapter X in view of the increase in the company's business, its solvency and the enhancement of its earnings. The failure of the board of directors to seek such reorganization, itself warrants the stockholders' action.

II.

THE CLAIMED RIGHT OF THE BONDHOLDERS TO COLLECT INTEREST AT 8% PER ANNUM HAS NOT BEEN ADJUDICATED.

Petitioners argue that the state Court decree, in allowing interest upon the unpaid principal of the bonds at the rate of 8% per annum, is final and binding upon the Bankruptcy Court unless fraud, therein, is proved. Such argument is fallacious. The rule of estoppel by judgment does not apply, as the question of the amount of interest, for which the corporation was liable, was never in issue nor litigated in the state Court proceeding. *Third National Bank of Louisville* v. *Stone*, 174 U. S. 432; *Cromwell* v. *County of Sac*, 94 U. S. 351, 353; *Washington, etc. Packet Co.* v. *Sickles*, 5 Wall. 580, 592. As, in the state Court proceeding, the corporation filed an answer admitting all of the allegations of the petition to foreclose (R. 37), the rate of interest owed could not have been in issue nor litigated. The shareholders not being a party to that proceeding, it is not *res adjudicata* as to them. The record, itself, shows that the Bondholders' Committee had on several occasions accepted interest in full at less than 8% per annum (R. 2).

III.

THE COMPANY IS SOLVENT.

In addition to the facts, disclosing the solvency of the corporation, set forth in respondent's Answer In Opposition To Petition For Writ Of Certiorari, respondent wishes to point out that the record, itself, discloses that the company had a substantial good will value even in May 1941 (R. 67). Petitioners claim that an indication of insolvency is the action of the directors, in September 1941, authorizing the purchase of bonds at not more than twenty-five cents on the dollar—the basis of that claim is not stated nor is it apparent. There is present, however, an indication that the stock itself had a value in March 1942, for at that time Mr. Kettering, one of the Committee members, individually acquired some of that stock (R. 47).

In the case of *Institutional Industries* v. *C. M. St. P. R. R. Co.*, 318 U. S. 523, this honorable Court held that even though there had been increased earnings which might be considered abnormal, such earnings were not sufficient to permit a dividend on the new preferred or common stock proposed to be issued and, therefore, this Court would not say that the junior interests had carried the burden of showing that subsequent events made necessary a rejection of the Commission's plan. This Court did not hold that an increase in earnings should be ignored and, in fact, in that decision the holding in *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, that the only true criterion of the value of the debtor's property is its earning capacity, was reaffirmed and approved.

IV.

"NO REASONABLE EXPECTATION THAT A REASONABLE PLAN OF REORGANIZATION CAN BE EFFECTED."

Under this heading of petitioners' Brief in support of their petition for certiorari, petitioners again assume to speak for the bondholders, themselves, as to whether or not the bondholders would consent to a plan of reorganization as and when the same is presented. Petitioners cite a number of cases in support of their contention that the instant petition should be dismissed, it being unreasonable to expect that a plan of reorganization can be effected. Not one of the cases cited is in point.

The case of *Fidelity Assurance Asso.* v. *Sims*, 318 U. S. 608, clearly is not applicable to the instant facts. There it was admitted that the debtor was insolvent and that no reorganization, as a going concern, was possible. A plan had been presented which was, in effect, merely an alternative for ordinary bankruptcy without any readjustment of the rights of creditors and stockholders *inter se*. The only question there presented was whether a proceeding for liquidation was proper under Chapter X and it was held that such proceeding was not contemplated by Chapter X. It was further held that, in that particular case, the liquidation, there sought, could be accomplished as well in the pending state Court proceeding as in the Federal Court and that an original bankruptcy proceeding could not be permitted for, unless Chapter X applied, the action had been instituted in the wrong district.

In the case of *Tennessee Publishing Company* v. *American National Bank*, 81 Fed. 2nd. 463, a plan of reorganization had been presented and dissented from by fifty per cent of the creditors. The Circuit Court of Appeals

believed that the lack of feasibility of the plan affected the good faith in its filing; this holding was dissented from by Judge Allen. When this Court passed upon the case, 299 U. S. 18, it was said, page 22:

> "Nor do we need to inquire as to the precise limits of the concept of 'good faith' as required by Section 77B, what ever these limits may be, the statute clearly contemplates the submission of a plan of reorganization which admits of being confirmed as 'fair and equitable' and 'feasible'. * * * Unless the District Judge finds that the plan has these qualifications he need go no further. Unless he so finds he has no authority to proceed."

Obviously this Court grounded its decision on the lack of fairness and feasibility of the plan which had been presented. In the instant case, no plan has been or could have been presented as yet.

The case of *Minati Sugar Co.* v. *Mock*, 75 Fed. 2nd. 284, was a reorganization proceeding under Section 77B. The Court held that the creditors filing such a petition should have shown that a plan of reorganization would be forthcoming. Under Section 77B creditors could propose a plan but as, under Chapter X, if a Trustee is appointed, only the Trustee can propose a plan (*Bankruptcy Act*, Sec. 169, 11 U.S.C.A. 569) respondent could not have alleged that a plan would be presented as the right so to do could, here, have been determined only by subsequent events.

The case of *In Re Francfair Inc.*, 13 Fed. Sup. 513, involved the question of whether the plan there presented was fair and feasible. Likewise, in *In Re Reliable Estates, Inc.*, 33 Fed. Sup. 588, a plan of reorganization had been presented and it appeared that the debtor's own petition disclosed that the property was worth less than the mortgage and a voluntary petition in bankruptcy had previously been filed disclosing the debtor's interest in the property as "none".

In *Seaboard Terminal Corp.* v. *West Md. R. R.*, 108 Fed. 2nd. 911, the Court found that the debtor had no property which could be the basis of a reorganization and that in the previous ten years of its history its debt had constantly increased. Here, the debtor has property, which not only can be the subject of reorganization, but unless a reorganization can be had under Chapter X, will be wholly lost to it and the value of that property exceeds the mortgage debt, which debt has been periodically reduced. In addition, the corporation here has shown large earnings since 1941 and has the capacity for a continuation of those earnings, if its equipment is modernized and its manufacturing and sales policies made more progressive.

V.

REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A.

Applicability of John Hancock Mutual Life Insurance Co. vs. Casey, 141 Fed. 2nd. 104.

Petitioners cite the above case as authority for their contention that reorganization, here, is either impossible or unnecessary, on the theory that any plan must be acceptable to the Bondholders' Committee and, if acceptable, no court proceedings are called for. That case did not so hold.

The plan presented, there, proposed a utilization of funds, received by the debtor from a condemnation proceedings, to make good the debtor's mortgage default

(but not to pay, or alter the mode of payment of the unpaid balance of the mortgage), the balance to become a part of the general assets and be used to pay unsecured creditors over a period of years. The mortgagee claimed it was entitled to the entire condemnation proceeds for its damages by reason of the decline in value, or impairment of its security. The Trustee conceded that no reorganization would be possible if the Court should find that the proceeds belonged to the mortgagee. The court did not determine that question but concluded that a reorganization, under Chapter X, was either unnecessary or impossible, for all the debtor would have obtained by the plan was an extension of its unsecured debts which was obtainable under Chapter XI, in which event the proceedings could be transmuted into a Chapter XI proceeding; it was further held that if the District Court should determine that the condemnation fund belonged to the mortgagee, then reorganization was concededly impossible and the proceeding should be transmuted into one of ordinary bankruptcy.

B.

"A Possible Method of Reorganization."

This subdivision of petitioners' argument is wholly irrelevant as there has been no plan of reorganization presented. The argument amounts to the creation and destruction of a strawman, namely, the description of a plan of reorganization to which, if presented, the Bondholders' Committee would not consent and the reasons why they would refuse. There is nothing whatever in the record which discloses that additional capital is necessary, that, if necessary, the stockholders would refuse to make any contribution, that the bondholders would be required to put in further money or that outside capital could be ob-

tained only by subordinating the present bonds to a new loan. It is also possible that a new mortgage could be procured in amount sufficient to pay off the principal and interest due on the present mortgage, in which event the consent of the bondholders would not be necessary. (Bankruptcy Act, Secs. 179, 216 (7), 11 U.S.C.A. 579, 616 (7).

C.

"Duty of Corporation to Make Defense in Foreclosure Suit."

The argument presented by petitions under this subdivision is unique. It is that if the directors of a corporation whose duty it is to present, in a foreclosure action against it, all existing defenses, fail to present those defenses, then it becomes the duty of the stockholders, who are not parties to that action, to present such defenses and, failing so to do, the stockholders are barred from protecting the corporation's interests in any other legal proceedings otherwise available to the corporation and to the stockholders. To state the argument demonstrates its fallacy.

D.

"Solvency of the Corporation."

Respondent's allegation that there would be a deficiency arising from the sale of the assets under the foreclosure decree is certainly not an admission that the company is insolvent. Such a sale would be a distress sale and the value of the corporation, as a going concern, would be wholly lost thereby.

Even on the balance sheet and earning statements for the year 1942 the company is solvent, when there is taken

into account the approximate $30,000.00 of interest set forth therein as past due on the bonds, which is in excess of the amount actually due, and the fact that no good will value or going concern value is disclosed by such balance sheet, plus the fact that the appraised value of the machinery and equipment (R. 89) is $7008.45 more than their balance sheet value.

Respondent, in his Answer In Opposition To Petition For Writ Of Certiorari, stated the facts, as shown by the company's own balance sheet and profit and loss statement for the year 1943, to disclose to this Court that the earnings continued, during that year, at an even greater rate than in the preceding year and that there cannot presently be any doubt of its solvency.

CONCLUSION.

WHEREFORE respondent respectfully submits that the decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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